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Supreme Court

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United States

NO. 74-6421

ECONOMIC RESEARCH ANALYSTS, INC. and RICHARD W. McINTYRE,
Petitioners,

vs.

CYRIL M. HUDAK,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PORTER, TREISTER, DONSKY & STEWART
1428 Brickell Avenue
Miami, Florida 33131
Attorneys for Petitioner
By LAWRENCE C. PORTER

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The Petitioners, ECONOMIC RESEARCH ANALYSTS, INC. and RICHARD W. McINTYRE, pray that a writ of certiorari issue to review the opinion and judgment of the United States Court of Appeals for the Fifth Circuit, entered in these proceedings on August 26, 1974.

OPINIONS BELOW

The opinion of the Court of Appeals (Appendix B, p. 4, *infra*) is reported at 499 F. 2d 996. The Findings of Fact and Conclusions of Law of the United States District Court of the Southern District of Florida (Miami Division) were not published or incorporated into a reported opinion, and they are set forth in Appendix C (p. 14, *infra*).

JURISDICTION

The Order of Judgment of the United States Court of Appeals for the Fifth Circuit was entered on August 26, 1974. (Appendix A, p. 2, *infra*). The Petition was filed less than 90 days from the date aforesaid. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1); and pursuant to Rule 19.1(b), Supreme Court Rules. The Court of Appeals, Fifth Circuit, has decided an important question of Federal law which has not been, but should be, settled by this Court.

QUESTIONS PRESENTED

I

WHETHER OR NOT RESPONDENT'S OWN CONDUCT PRIOR TO THE INSTITUTION OF THESE PROCEEDINGS (HE HAD ALREADY OBTAINED IN STATE COURT SUBSTANTIALLY ALL OF THE RELIEF HE SOUGHT IN FEDERAL COURT.) REQUIRES THAT A FEDERAL COURT DENY HIM THE PRIVILEGE OF PENDENT JURISDICTION BECAUSE APPLICATION OF THE DOCTRINE IN

THIS SITUATION WOULD DO VIOLENCE TO THE VERY PRINCIPLES UPON WHICH IT IS GROUNDED: JUDICIAL ECONOMY, CONVENIENCE, AND FAIRNESS TO LITIGANTS.

II

WHETHER OR NOT AN AGENT'S TORTS COMMITTED SOLELY FOR HIS OWN PURPOSES ARE COMMITTED WITHIN THE SCOPE OF HIS EMPLOYMENT.

CONSTITUTIONAL PROVISIONS INVOLVED

Article III, Section 2 of the United States Constitution provides in pertinent part as follows:

> Section 2. The judicial power shall extend to all cases in law and equity arising under this Constitution, the laws of the United States . . .

STATUTES AND REGULATIONS INVOLVED

1. Title 15, U.S. Code—§78j provides in pertinent part as follows:

> *"Manipulative and deceptive devices.*
>
> "It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce or of

the mails, or of any facility of any national securities exchange —

"(a) . . . . . .

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors".

2. Securities Exchange Commission Rule 10b-5:

"Employment of Manipulative and Deceptive Devices

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

"(1) to employ any device, scheme, or artifice to defraud,

"(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

3. Florida Statutes 517.301:

"*Fraudulent transactions; falsification or concealment of facts.* — It is unlawful, and a violation of the provisions of this chapter, for any person:

"(1) in the sale or purchase of any security in this state, including any security exempted under the provisions of §5i7.05, and including any securities sold in any transaction exempted under the provisions of §517.06, directly or indirectly:

"(a) To employ any device, scheme or artifice to defraud;

"(b) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made not misleading;

"(c) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

"(2) To publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, communication or broadcast which though not purporting to offer a security for sale, describes such security for a consideration received or to be received directly or indirectly from an insurer, underwriter, or dealer, or from an agent or employee of an insurer, underwriter or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

"(3) In any matter within the jurisdiction of the department to knowingly and willfully falsify, conceal or cover up by any trick, scheme, or device, a material fact, or make any false, fictitious or fraudulent statement or representation, or make or use any false writing or document, knowing the same to contain any false, fictitious or fraudulent statement or entry."

STATEMENT OF THE CASE

The Petitioners herein are Economic Research Analysts, Inc. ("ERA"), a registered broker/dealer, and Richard W. McIntyre ("McIntyre"), the Chief Executive of ERA. The Respondent, Cyril M. Hudak ("Hudak"), was granted a judgment against ERA and McIntyre for violations of Section 10(b) of the Securities Exchange Act of 1934, as amended, (15 U.S.C. Section 78j(b)) (the "Exchange Act") and Rule 10b-5 promulgated thereunder and for having perpetrated fraud as a matter of law. As shall be set forth with more

particularity below, the gist of Respondent's Complaint was that Richard F. Petersen ("Petersen"), a registered representative of ERA, perpetrated a fraud upon him in connection with the sale of certain securities.

In June of 1970, Respondent filed an action in the Circuit Court of the Eleventh Judicial Circuit of Florida, in and for Dade County, Florida against Marine Environmental Data, Inc., Francis C. Gibout, Richard F. Petersen, and Ann H. Petersen seeking recovery for violations of his rights under the registration provisions of the Florida Blue Sky law and the anti-fraud provisions of the Florida common law in connection with the offer and sale of securities of a mutual fund known as Colonial Ventures, a corporation called Stacey-Gifford Company, and a corporation called Marine Environmental Data, Inc. (Appendix D, p. 29, *infra*). Later, he obtained a Final Judgment by Default. The Petitioners were not named or mentioned in this Complaint.

Then, on April 11, 1973, Respondent filed a Complaint in the United States District Court for the Southern District of Florida seeking recovery against the Petitioners for violations of his rights as protected by Section 10b of the Exchange Act and by the anti-fraud provisions of the Florida common law.

Respondent testified that he purchased 200 shares of Common Stock in the Stacey-Gifford Company ("Stacey-Gifford") from Petersen in the latter part of August 1968. Respondent claimed he was dealing with Petersen as an agent of ERA. The trial court disagreed and ruled that when this purchase was made, Respon-

dent was dealing with Petersen as an individual. (This was implicit in the finding that Petersen was employed by ERA from September 13, 1968 to July 11, 1969, and in the finding whereby it was established that the Respondent believed he was dealing with Petersen as an agent of ERA from September 13, 1968 to July 11, 1969.) On September 13, 1968, Petersen was mailed a letter from ERA advising him that he had been assigned an ERA registered representative's code number. Before receiving this code number, he did not receive income from ERA. Therefore, the 200 shares of Stacey-Gifford were purchased by the Respondent before Petersen was actually an operating registered representative of ERA, and the Respondent knew this. Even though the mere delivery of these shares occurred later, when Petersen was employed by ERA, the negotiations and payment did not occur in the offices of ERA, but on the golf course of the La Gorce Country Club, in Miami Beach, and at or in Petersen's home, which is from where these securities were mailed.

The checks issued by the Respondent for this purchase, as well as for all the other purchases giving rise to this cause of action were issued to the order of Petersen, individually, not to ERA, and they were endorsed by Petersen or his own firm, not ERA.

The evidence indicates that on January 28, 1969, the Respondent agreed to purchase an as yet then undetermined number of shares of Colonial Ventures, and in connection therewith gave Petersen a check for $5,000 payable to the order of Petersen, not ERA. Petersen testified to the effect that the Respondent was aware that at the time the purchase price was paid, Colonial Ventures was not in existence and would be

forthcoming. Petersen then testified that he suggested to the Respondent that he (Hudak) use the Colonial Ventures money together with another $5,000 to buy shares in a new company being formed to capitalize on the then current craze for pollution-control equipment, said company being Marine Environmental. Petersen testified that he explained to the Respondent that he would not be buying the stock of Neurus Corporation ("Neurus"), an existing corporation, but that he would be participating in a private placement of securities of a new company. Petersen explained that Marine Environmental had an affiliation with Neurus as its sales arm in Florida, the technical founders and principals of Neurus being able to market their own product.

As stated earlier, all of the checks issued for payment of the aforementioned securities were made to the order of Petersen or his company. In addition, the Respondent never had an account with ERA, he received no confirmation slips or securities from ERA with respect to his transactions, nor did he ever receive a monthly statement of account from ERA.

In conclusion, the evidence indicated that Respondent never had an account with ERA and that in dealing with Petersen, the Respondent was dealing with him as an individual and not as an agent of ERA.

Petitioners moved to dismiss Respondent's District Court Complaint on the grounds that the Federal claim was barred by the statute of limitations and that the Complaint did not state a cause of action for common law fraud. Later, in their Proposed Findings of Fact and Conclusions of Law, the Petitioners argued that should the federal claim be denied, the state claim should fall

for lack of jurisdiction, there being no diversity of citizenship between the parties.

After the trial, Petitioners appealed to the United States Court of Appeals for the Fifth Circuit. Earlier, a case virtually identical to Respondent's *(O'Connell v. Economic Research Analysts, Inc. and Richard W. McIntyre)* was brought in the Southern District of Florida. This case was also decided adversely to the Petitioners, and this Judgment was also appealed. The two appeals were then consolidated for oral argument.

On appeal, the Fifth Circuit ruled that both Federal claims were barred by the statute of limitations applicable to 10b-5 litigation in Florida. However, this judgment, as a practical matter stood, because notwithstanding the failure of the Federal claim, the Fifth Circuit upheld the District Court's assumption of pendent jurisdiction by sustaining the State claim for Florida common law fraud.

REASONS FOR GRANTING THE WRIT
I. PENDENT JURISDICTION

Perhaps recognizing that the doctrine of pendent jurisdiction is not absolute and beyond reproach, Justice Brennan, speaking for the majority in *United Mineworkers of America v. Gibbs*, 383 U.S. 715 (1966) emphasized that the doctrine is one of discretion and not of plaintiff's right. The efficacy of certain criticisms of the doctrine are illustrated by the case at bar.

Traditionally, State Courts are and should be vested with concurrent jurisdiction: they may and should entertain and dispose of, at one sitting, Federal

and State claims. There are, of course, exceptions to this power. One of those exceptions appears to — but in fact does not — exist here: actions brought pursuant to the Exchange Act are to be tried in Federal Courts only. However, the kind of relief afforded by the Exchange Act is also afforded by the equivalent provision of the Florida Blue Sky Law.[1] Therefore, while it is true that a Florida State Court would not have been able to entertain this action, based as it was, upon the Exchange Act, it would have what can be called "effective" concurrent jurisdiction and it could afford plaintiff the kind of protection afforded by the Exchange Act. The result of the existence of the Florida Blue Sky Law remedy is that the Congressional policy of granting State Courts concurrent jurisdiction over Federal and State claims may be accommodated, and this is proper. Such being the case, it would be an affront to comity for this Court to exercise pendent jurisdiction and entertain the State claim.

More practically, the existence of this so-called "effective concurrent jurisdiction" can potentially resolve another criticism of pendent jurisdiction: if a State Court commits error with respect to Federal law, the injured party has ultimate redress in this Supreme Federal Court, but if a Federal Court commits error with respect to State law, there is no State Court from which the injured party may seek redress. Florida Courts have clearly indicated that the statute of limitations for securities fraud is two years. *Fowler v. Matheny*, 184 So. 2d 676 (4th D.C.A. 1966). Yet, it required a lengthy trial and appeal to establish this proposition in the Federal context.

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[1] Indeed, the Appellate Court below indicated that Section 517.301(1), F.S.A., is strikingly similar to Section 10b of the Exchange Act. *Hudak v. Economic Research Analysts, Inc. and Richard W. McIntyre*, 499 Fed. 2d 996 (5th Cir. 1974).

Moreover, the existence of "effective concurrent jurisdiction" tends to nullify another argument used in support of pendent jurisdiction, namely, that a plaintiff who cannot append a State claim to a Federal cause of action may have to bring a separate law suit in State court to have this relief. The argument fails because a Florida State court could effectively embrace and vindicate both the Respondent's Federal rights (by virtue of Section 517.301(1), F.S.A.) and his State rights (common law fraud). The Plaintiff-Respondent would hardly have to bring a separate law suit in State court to prove common law fraud. He has already done so, and he has a judgment. Ironically, the expense of obtaining this relief was minimal: the judgment was granted by default.

Gibbs, supra, also reminds us that the "whole tendency" of Supreme Court decisions is "to require a plaintiff to try his . . . whole case at one time." The fallacy of this justification for the assumption of pendent jurisdiction may be exposed by theoretical and practical grounds, and both objections to this authority for assuming pendent jurisdiction are epitomized by the case at bar.

The "whole tendency" argument was borrowed from *Baltimore S. S. Co. v. Phillips,* 274 U.S. 316 (1927). Phillips, the plaintiff injured seaman, brought one Federal claim. He prevailed. Later, unsatisfied, he asserted another Federal claim. His second claim was denied, the denial being based upon the conclusion that "second chance" federal litigation was precluded by the doctrine of res judicata. The Respondent in State court sued those persons he felt were primarily responsible for his losses. He, too, prevailed the first time. Now, for

reasons he has chosen not to divulge, Respondent wants a second chance. According to *Phillips*, he should not have it. He has already had his day in court, and he obtained the relief he sought. What difference should it make that he now stands in Federal court to take a second bite of the apple? Since pendent jurisdiction is a creature of equity, it would be incongruous to apply the doctrine here because application of the doctrine would produce an inequitable result by allowing the Respondent to have this second chance.

Moreover, it is suggested that *Phillips* is not good authority for *Gibbs*. *Gibbs* does not implement the basis of res judicata as the same was implemented in *Phillips*. The basis of the doctrine is that a plaintiff must present all his claims (or causes of action, if you will) the first time he sues, because it would be unfair to the courts and society to give him a second chance. *Phillips* invoked res judicata and denied the second claim. *Gibbs* invoked res judicata and entertained what would be the equivalent of the second claim. Based on jurisdictional results, *Phillips* is hardly authority for *Gibbs*. Indeed, if res judicata is to be used in the broadest equitable sense and in the context of power and its rightful exercise, it would seem that *Gibbs-Phillips* ought to preclude pendent jurisdiction in this cause as the Plaintiff-Respondent already obtained relief and should have sued the Petitioners that first time around.

Yet it is also suggested that the flaw in the "whole tendency" argument, as it is based upon the demands of res judicata, is more subtle than mere misreliance upon *Phillips*. The history of the case at bar will reveal this flaw.

What is really significant here is *Phillips'* reference to an exception to res judicata which specifically addresses itself to jurisdiction and the rightful exercise of the power that superior courts inherently have over lower ones. Respect is a two-way street, and *Phillips* recognizes that res judicata will not bar a claim that a prior court would not hear because it lacked jurisdiction.

The State court would have had jurisdiction to entertain the State claim in Respondent's complaint, the State court did have jurisdiction to entertain that count, and as a practical matter, the State court did give relief for that claim. All potential claims and all potential defendants should have been presented and named, respectively, at that time.

If res judicata will not bar a claim that a lower court would not hear because it lacked jurisdiction, but, if, however, a lower court did have jurisdiction over and did hear substantially the same claim (and afford relief), then it ought to follow that a higher court (here, a Federal court), by virtue of res judicata, should not entertain pendent jurisdiction. Even the exception to the doctrine is not available.

In summary, it is submitted that because the Respondent has already made his claims and made them against all he then thought responsible, and because he is required to try all his claims against all he thinks are responsible at one time, res judicata, as it pertains to pendent jurisdictional concepts, ought to bar Respondent's claim for Florida common law fraud. It is further submitted that the exception to res judicata — that the doctrine will not bar a claim that a prior

court could not entertain because it lacked jurisdiction — specifically *precludes* the assertion of pendent jurisdiction because the prior court did not lack jurisdiction. The relevance of the exception is particularly important because it is an aspect of the doctrine of res judicata that specifically addresses itself to the relationship between res judicata and jurisdiction, and because use of the doctrine of res judicata figured prominently in *Gibbs*.

Gibbs also cited to similar provisions of the Federal Rules of Civil Procedure to justify its broad application of federal jurisdiction. One of the leading cases concerned with the joinder of other parties, with compulsory counter-claims, and with cross-claims, when there was original federal jurisdiction over the main claim, is *Moore v. New York Cotton Exchange*, 270 U.S. 593 (1926). *Moore* teaches that Federal courts may assume jurisdiction over these non-federal claims when they arose out of the same "transaction or occurrence" or had a "logical connection", and the reasoning of *Moore* figured strongly in *Hurn v. Oursler*, 289 U.S. 238 (1933).

But is the reasoning in *Moore* sound? Does this reasoning, based on the facts in *Moore*, support a broad approach to pendent jurisdiction. The plaintiff in *Moore* asserted a federal anti-trust claim against the defendant. The defendant counter-claimed with an allegation that the plaintiff violated state law. The Supreme Court entertained jurisdiction over both claims, and in so doing, asserted jurisdiction over a State cause of action (the counter-claim) which could not have been the basis of a Federal law suit, there being no Federal question or diversity jurisdiction. But the cases relied upon in *Moore* stand for the traditional

policy that Federal jurisdiction to determine a State claim over which there would normally not be Federal jurisdiction must be implied when the claim over which Federal jurisdiction does exist cannot be determined without first deciding the State question. *Champion Spark Plug Co. v. Champion Ignition Co.*, 247 F. 200 (Mich. 1917); *Cleveland Eng'r. Co. v. Galion Dynamic Motor Truck Co.*, 243 F. 405 (Ohio 1917); *Xenia Branch Bank v. Lee*, 7 Abb. Pr. 372 (N.Y. Sup. Ct. 1858).

However, the facts in *Moore* indicate that jurisdiction over plaintiff's anti-trust claim could have been and was decided without consideration of defendant's state law counter-claim. Also, *Moore* runs counter to earlier cases denying jurisdiction over counter-claims which did not have to be considered to resolve plaintiff's claim.

Although no counter-claim is involved here, it would not have been necessary for the Federal trial court to first resolve the State question in order to determine if it had jurisdiction over the Federal question. Indeed, the State question had already been determined in favor of the Plaintiff-Respondent, so that his having asked for a re-entertainment of that State question was a waste of the Federal Court's time.

There is, of course, a long line of cases which holds that, after the taking of evidence, a Federal court should not decline to entertain a State cause of action even if the Federal claim which gave rise to jurisdiction has been found wanting. See, e.g., 3A Moore's *Federal Practice*, Paragraph 18.07 (1.-4) and Supplement. Judicial economy, etc., are the reasons advanced in support of this admonition. But, there is also recent

case law to the contrary, and this case correctly emphasizes that the elemental teaching of *Gibbs, supra,* is to the effect that pendent jurisdiction is a matter of discretion. *Webb v. Bladen,* 480 Fed. 2d 306 (4th Cir. 1973):

> The district court may exercise its discretion to dismiss State claims at any point during the proceedings. Thus, although the district court should weigh the fact of already completed litigation, it may nevertheless often be proper to dismiss State claims after a trial.
>
> 488 Fed. 2d at 309.

Gibbs itself also advises that dismissal of a State claim after litigation may be merited. 383 U.S. at 727.

The case at bar is a perfect example of why this Court, after a trial on the merits, should find that there is here no Federal jurisdiction and accordingly dismiss the case. Defendants originally suggested to the Trial Court that Plaintiff's claim was barred by the statute of limitations, or alternatively, that the Trial Court should implement a two-year limitations period.

Although no reasons were given in support of the Trial Court's denial of Defendants' Motion to Dismiss, it seems a fair inference that the Motion was denied because the Trial Court did not know when the fraud was discovered, or when, in the exercise of due diligence, it should have been discovered. The absence of this information therefore necessitated a full trial. In short, the only way Defendants could possibly properly present their statute of limitations defense to the Trial Court was at or after trial.

In summary, since the Federal cause of action here was found to be barred by the two-year statute of limitations, this case has resolved itself into what is essentially a State claim for common law fraud which ought to be tried in State Court. With respect to the argument that such a conclusion would be hindsight adjudication and would render the entire Federal court trial an exercise in futility, with respect to the argument that such a conclusion — which ought to result in a dismissal of this law suit — would be uneconomical, unfair, and inconvenient, Petitioners respectfully suggest to the Court that the situation and result are of Respondent's own making. He brought a law suit in State Court to recover his loss, he obtained his judgment, and by renewing this claim in Federal court, he is the person who created the uneconomical, unfair, and inconvenient situation which exists now. Dismissal of this law suit would not prejudice Respondent since he already has a judgment. Worse yet, affirming the opinion below would afford the Respondent potential double recovery, and surely this would not be an equitable result.

Therefore, Petitioners request that since the Federal cause of action has been eliminated, the Court should dismiss the State cause of action on the grounds of lack of jurisdiction. This would be the most appropriate step for the Court to take. The Respondent has a judgment. By bringing the Federal law suit, the Respondent has wasted an enormous amount of judicial resources, money and time. Federal judicial resources are already strained.[2]/ The Respondent should not be

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[2] See, for instance, The Geographical Boundaries of the Several Judicial Circuits: Alternative Proposals, 487 Fed. 2d.

rewarded for having wasted all this time, and certainly he should not be given potential double relief. His complaint should be dismissed for lack of jurisdiction.

The Court should set an example.

II AGENCY

"A principal is not liable for his agent's tort unless it is 'within the scope of the agent's employment. *It is not within the scope of the employment if it is done for the agent's purposes only . . .*" (Emphasis supplied). *M. J. Uline Co. v. Cashdan*, 171 F. 2d 132 (DC Cir. 1948); *Park Transfer Co. v. Lumbermen's Mut. Casualty Co.*, 142 F. 2d 100 (DC Cir. 1944). This is the law of Florida, *City of Miami v. Simpson*, 172 So. 2d 435 (Fla. 1965); and it has been so held in the Fifth Circuit, *City of Green Cove Springs v. Donaldson*, 348 F. 2d 197 (5th Cir. 1965), and *Collazo v. John W. Campbell Farms, Inc.*, 213 F. 2d 255 (5th Cir. 1954).

Since Respondent asserted the agency, the burden was on him to prove it. *Bogue Electric Mfg. Co. v. Coconut Grove Bank*, 269 F. 2d 1 (5th Cir. 1959). *M. J. Uline, supra*, would seem to require a plaintiff to prove that the tort was done for the principal's purposes. Respondent did not prove this. In fact, the evidence at trial was clear and unrebutted to the effect that Petersen's dealings with the Respondent were only for his (Petersen's) own purposes and personal gain — not ERA's and McIntyre's. Petersen testified that he paid McIntyre $3.00 or $3.50 (McIntyre's cost) per share of Stacey-Gifford stock which had then been sold to Respondent by Petersen for $6.00 per share. If anything, McIntyre suffered a loss in the transaction since

Petersen did not pay him in full, and ERA never received commissions for Petersen's sales to the Respondent. Since the sales to the Respondent were for Petersen's benefit only, they were not within the scope of his employment. Therefore, ERA and McIntyre should not be held liable for the fraud independently, privately and secretly perpetrated by Petersen.

The foregoing notwithstanding, it cannot be said that Petersen was clothed with apparent authority. In *Bogue, supra,* the Court defined apparent authority and described the limits of liability attaching thereto. In so circumscribing said limits, the Court warned that the existence of mere "(i)solated or occasional transactions are not enough." *Bogue, supra* at 5. Respondent has complained of three transactions. The fact that his purchase of Stacey-Gifford occurred prior to Petersen's registration with ERA — during which time he knew Petersen was not an agent of ERA — not only tends to isolate those transactions even more, but tends to rebut his claim that he somehow believed he was dealing with an agent of ERA.

Bogue also states that for there to be apparent authority, the third party must change his position in reliance on a representation by the principal that his agent has authority. The Respondent did not change his position after Petersen became an active registered representative of ERA (which was on September 13, 1968). The pattern established in 1968 continued throughout the year and into 1969. In other words, Respondent had dealt with Petersen as an individual *before* Petersen joined ERA, and he continued to deal with Petersen as an individual *after* Petersen joined ERA. The Respondent continued to deal with Petersen

as an individual also after Petersen had *left* ERA: the delivery of the 5,000 shares of Marine Environmental occurred on July 17, 1969, six days *after* Petersen left ERA, and, when he left ERA, Petersen advised the Respondent and many others. The trial judge also concluded that after Petersen left ERA on July 11, 1969, the Respondent no longer believed he was dealing with Petersen as an agent of ERA. All of the Respondent's checks are made payable or endorsed to Petersen individually or to his (Petersen's) company and never to ERA or McIntyre.

The fact that none of these checks were made payable to or were endorsed by ERA or McIntyre would seem to be obvious notice to the Respondent that he was not dealing with an agent of ERA. Therefore, a "person of ordinary prudence, conversant with business usages and the nature of the particular business" would hardly be justified in presuming that he was dealing with an agent of another company. *Bogue, supra,* at 3-4. *Kamen & Co. v. Paul H. Aschkar & Company,* 382 F. 2d 689, 696 (9th Cir. 1967). *Cf., United Bonding Ins. Co. v. Banco Suizo Panameno, S.A.,* 422 F. 2d 1142 (5th Cir. 1970), to the effect that a third party cannot rely on an agent's apparent authority if the circumstances are such as would put a reasonable man on inquiry.

Appropriate here is a description, from the Respondent himself, of the atmosphere in which he conducted his business with Petersen. The Respondent was hardly a novice investor, his protestations to the contrary notwithstanding. And, when buying securities in the past, he customarily made his checks payable to the brokerage firm and not to the individual salesman; he received his securities in the mail from the brokerage

house and not from the home of the salesman; and, unlike the situation at bar, he received confirmation slips and monthly statements from the brokerage house.

The Respondent's dealings with Petersen were different in still another way. Many, if not most, of the negotiations and/or transactions were conducted in the luxury of the La Gorce Country Club, in Miami Beach. Perhaps there, the Respondent's no doubt cautious financial instincts (he was a Catholic Priest) had difficulty resisting the temptation to keep up with the casual and sporting wealth whose company he enjoyed. At any rate, the locker room at La Gorce is not the business office of ERA, so that, in this connection, Petersen was hardly clothed with apparent authority.

In the context of the securities world, one of the leading agency cases is *Kamen & Co. v. Paul H. Aschkar & Co.*, 382 F. 2d 689 (9th Cir. 1967), which found that the salesmen involved in a fraud had no real or apparent authority to do what they did. Referring to the Restatement of the Law of Agency, the Court quoted:

> ". . . Any substantial departure by an agent from the usual methods of conducting business is ordinarily a sufficient warning of lack of authorization."
>
> ***
>
> . . . Likewise, if the representations are as to a matter concerning which the other party, in view of business customs and other facts which he knows *or should know*, should realize

the agent is not authorized to make statements, the principal is not liable for them."
382 F. 2d at 695.

In the case at bar, there were substantial departures from the usual methods of conducting business, and any reasonable man should have been aware of these departures. The checks written by the Respondent in payment for the securities were issued to the salesman *himself*, not to ERA as would have been normal and proper, and they were never endorsed by ERA, as would have been normal and proper. The Respondent did not receive confirmation slips or billing statements from ERA, as would have been normal. Again, a reasonable man, especially one with some brokerage experience, claiming he dealt with a brokerage firm should have realized that the failure to receive this evidence of the brokerage firm's participation in the transactions was a departure from the normal method of conducting business. Finally, even though he waited four months (from January to May or June, the latter dates being the dates when Colonial Ventures was abandoned in favor of Marine Environmental) to receive his Colonial Ventures, he never complained to ERA.

Furthermore, assuming that the Respondent knew — as he testified he did — that Petersen was an agent of ERA, he had the duty to determine for himself Petersen's authority to accept checks made payable to himself and not ERA:

"A third person dealing with a known agent may not act negligently with regard to the extent of the agent's authority or blindly

> trust the agent's statements in such respect. Rather, he must use reasonable diligence and prudence to ascertain whether the agent is acting and dealing with him within the scope of his powers. The mere opinion of an agent as to the extent of his powers or his mere assumption of authority without foundation, will not bind the principal; and a third person dealing with a known agent must bear the burden of determining for himself, by the exercise of reasonable diligence and prudence the existence of nonexistence of the agent's authority to act in the premises. The principal, on the other hand, may act on the presumption that third persons dealing with his agent will not be negligent in failing to ascertain the extent of his authority as well as the existence of his agency.
>
> *3 Am. Jr. 2d*, Agency 678, p. 482.

State of mind is subjective. A mental conclusion is the result of impressions made upon one by tangible evidence, i.e., by facts. A conclusion in the mind of a third party that he is dealing with an agent of another can only be reasonable if the facts justifiably support the conclusion. One's beliefs and one's acts based thereon should be consistent. Believing that one is an agent of another but making payment to him in his individual capacity, not as an agent, and not to his principal, is a belief which is inconsistent with one's acts. The Respondent's testimony about his state of mind is not justified by the facts; the mental conclusion he claimed to have arrived at is therefore illogical. Cf., *Ernst Iron Works v. Duralith Corporation*, 200 N.E. 683 (CA NY 1936), and *Parsons v. Federal Realty Corp.*, 143 So. 912 (Fla. 1931).

Since the Respondent claimed at trial that he was dealing with Petersen as an agent of ERA, why did he make his checks payable to Petersen individually and not to ERA. The Respondent claimed he made his checks out to Petersen because Petersen told him to do so and because he felt that he was dealing with ERA through Petersen. The situation is not much different from one where a person, buying merchandise, does so at a salesman's home, pays by check made out to the salesman and not the store, and then, after deciding the goods were not what he wanted, attempts to take them back to the store (where he had never done business). Reasonable men simply do not conduct their business in such a manner, and it would therefore be inequitable to punish ERA and McIntyre for the Respondent's failure to supervise his affairs prudently. If the Respondent now claims he was dealing with ERA, why, when he sued Petersen in the Summer of 1970 did he not sue McIntyre and ERA as well? If the Respondent claimed he was dealing with an agent of ERA, why, when he spoke to a representative of ERA after the sale, did he not make demand against ERA? The irony of the foregoing is, of course, that the Respondent never had an account with ERA, *and Petersen explained to the Respondent that these were private transactions wherein he (the Respondent) was dealing with him (Petersen) on a personal basis.*

For the foregoing reasons, this Court would only be justified in concluding that since Petersen had neither actual nor apparent authority to act for ERA as he did, ERA and McIntyre are not liable for his tortious acts.

CONCLUSION

For the reasons stated, this Petition for Writ of Certiorari should be granted. It would be inappropriate for a Federal Court to entertain pendent jurisdiction, and notwithstanding, as a matter of law, Petitioners should not be held vicariously liable for the acts of their agent, since these acts were committed by the agent for his own purposes exclusively.

Respectfully submitted,

PORTER, TREISTER,
DONSKY & STEWART
1428 Brickell Avenue
Miami, Florida 33131
(305) 358-8850

By _____
LAWRENCE C. PORTER,
of Counsel

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that three copies of this Petition for Writ of Certiorari and Appendix annexed thereto were served upon Jeffrey Tew, Esquire, of TEW, TEW & MURRAY, 200 Southeast First Street, Miami, Florida 33131, Counsel for Daniel O'Connell, Respondent, by depositing the same in a United States mail box with first class postage prepaid, addressed accordingly, and in accordance with Rule 33, Supreme Court Rules, this day of November, 1974.

By _____
LAWRENCE C. PORTER,
of Counsel

PORTER, TREISTER,
DONSKY & STEWART
1428 Brickell Avenue
Miami, Florida 33131
(305) 358-8850

APPENDIX

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APPENDIX A

United States Court of Appeals
for the Fifth Circuit

October Term, 1973

No. 73-3742

D. C. Docket No. CA-73-619

CYRIL M. HUDAK,
Plaintiff-Appellee,

versus

ECONOMIC RESEARCH ANALYSTS, INC.
and RICHARD W. McINTYRE,
Defendants-Appellants.

Appeal from the United States District Court for the Southern District of Florida

Before BELL, GOLDBERG and CLARK, Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Florida, and was argued by counsel:

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, affirmed in part and reversed in part;

It is further ordered that defendant-appellant, Economic Research Analysts, Inc., pay to plaintiff-appellee, the costs on appeal to be taxed by the Clerk of this Court.

August 26, 1974

Issued as Mandate: SEP 17 1974

APPENDIX B

Aug. 26, 1974.

[Title Omitted]

Appeal from the United States District Court for the Southern District of Florida.

Before BELL, GOLDBERG and CLARK, Circuit Judges.

GOLDBERG, Circuit Judge:

Defendants Economic Research Analysts, Inc. ("ERA"), a registered broker/dealer, and Richard W. McIntyre, its president, bring this appeal from a judgment of the United States District Court for the Southern District of Florida holding them jointly and severally liable to plaintiff Hudak under sections 10(b) and 20(a) of the Securities Exchange Act of 1934[1] and the Florida common law of fraud for losses incurred by Hudak in the course of certain securities transactions.

The present litigation arises from the activities of one Richard F. Petersen who, from September 13, 1968 to July 11, 1969, was employed by ERA as a registered representative for the purpose of selling securities to the public. While ostensibly acting in that capacity, Petersen collected money from plaintiff on the basis of representations that he had made and assurances that he would continue to make prudent investments on Hudak's behalf. The district court found that virtually

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[1] 15 U.S.C. §§78j(b), 78t(a).

all of those statements were false, and that Petersen had solicited money for legitimate purchases, converted it to his own use, and then covered his defalcations by persuading Hudak to accept worthless securities, which he touted highly.

Defendants do not dispute either the accuracy of these findings or the fact that this pattern of deceptive practices is sufficient to make out a case against Petersen. They protest vigorously, however, that they are not accountable to plaintiff for the wrongs committed by their employee and that, even should such liability exist under either federal or state law, they are shielded from its impact by the applicable statutes of limitations. Finding defendants' attack partially successful, we reverse as to the individual defendant McIntyre, but affirm the judgment against ERA on the basis of the pendent state fraud claim.

THE FEDERAL CLAIM

Though defendants raise numerous objections to the imposition below of liability under federal securities law, we are met at the outset by the question of the proper limitations period to apply to any such federal claim. The analysis required of a court in determining the proper time measure for private actions brought under the federal securities provisions at issue here was recently sketched by Judge Clark in his opinion for this Court in Sargent v. Genesco, Inc., 5 Cir. 1974, 492 F.2d 750, 758.

The federal securities laws contain no limitation period that is expressly applicable to claims under section 10(b) and rule 10b-5, nor does federal law

prescribe any general statute of limitations for civil actions. Consequently, the limitation period which the forum state applies to the state remedy which bears the closest substantive resemblance to rule 10b-5 and which best effectuates its purpose to be applied. [citations omitted].

Evidently relying on our observation in Azalea Meats, Inc. v. Muscat, 5 Cir. 1967, 386 F.2d 5, 8, that "the gravamen of an action brought under section 10(b) of the Securities Exchange Act of 1934 is fraud," the district court measured the timeliness of plaintiff's action against the three-year limitations period provided by §95.11(5)(d) Florida Statutes for "an action for relief on the ground of fraud." Defendants contend, however, that §517.301(1) of the Florida blue sky laws, which deals with fraudulent transactions in securities, more nearly embodies the policies behind section 10(b) and the related Rule 10b-5, and that the two-year limitations period applicable in suits brought to rescind sales conducted in violation of that statute should therefore govern a 10b-5 action in Florida. We find this argument persuasive.

The anti-fraud provisions of the Florida securities statutes and Rule 10b-5, promulgated by the Securities and Exchange Commission as "necessary and appropriate" for the implementation of section 10(b) of the 1934 Act, address the problems of false and misleading communications involving the sale of securities with strikingly similar language. Indeed, as an examination of the texts set out in the margin

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This limitations period is set out in §517.21 Florida Statutes.

indicates[1], commentators have justifiably referred to §517.301(1) of the Florida Statutes as "the mirror image of Rule 10b-5."[1] This congruence between the state and federal schemes is not limited to a surface resemblance, but extends as well to judicial elaborations on the elements necessary to make out a case—requirements differing significantly from those applicable to the Florida common law of fraud.

[1, 2] The common law remedy imposes upon the plaintiff the burden of demonstrating, *inter alia*, "(1) a false statement of fact; (2) known by the defendant to be false at the time it was made; (3) made for the purpose of inducing the plaintiff to act in reliance

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17 C.F.R. §240.10b-5 (Rule 10b-5) provides that:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

§517.301 Florida Statutes provides in part that:

It is unlawful, and a violation of the provisions of this chapter, for any person

(1) In the sale or purchase of any security in this state, including any security exempted under the provisions of §517.05, and including any securities sold in any transaction exempted under the provisions of §517.06, directly or indirectly

(a) To employ any device, scheme, or artifice to defraud;

(b) To obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading;

(c) To engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security.

[1] Spencer & Bobroff, Disclosure Under the Florida Securities Act, 23 U. Miami Law Review 593, 594.

thereon . . ." Poliakoff v. National Emblem Insurance Company, 249 So.2d 477,478 (Fl.App., 3rd Dist. 1971). In contrast, both this Circuit and, as the parties agree, the Florida state courts have relaxed such traditional notions of scienter and evil purpose in actions brought under their respective securities regulation provisions. *See* Smallwood v. Pearl Brewing Company, 5 Cir. 1974, 489 F.2d 579, 606; State v. Houghtaling, 181 So.2d 636 (Fla.Sup.Ct.1965). Though it would appear that Florida has not entirely abandoned the requirement of a showing of culpability, Sparks v. State, 256 So.2d 537 (Fl.App., 4th Dist.), nor yet embraced a pure negligence standard, the present hesitant growth of the Florida blue sky law accurately tracks the development of federal securities regulation in this Circuit. In our most recent statement on the scienter requirement in 10b-5 litigation, we observed that the law is presently in a state of considerable flux, and held it sufficient for the moment to note that "some culpability, beyond mere negligence, is required." Smallwood v. Pearl Brewing Company, *supra*, 489 F.2d at 606.

[3] We concur in the reasoned judgments of the Seventh and Eighth Circuits which, when faced with present choice between a forum state's fraud and blue sky limitations periods for use in federal securities litigation, found the similarity between the blue sky and 10b-5 scienter requirements crucial to their determination. Parrent v. Midwest Rug Mills, Inc., 7 Cir. 1972, 455 F.2d 123; Vanderboom v. Sexton, 8 Cir. 1970, 422 F.2d 1233. Given the similarity of §517.301(1) and Rule 10b-5, in both language and interpretation, and the congruence between the specific remedy sought here—return of the purchase money—and the remedy of recission for which Florida securities law provides a

two-year statute[3], we hold that the district court erred in applying the three-year fraud period. The present action was filed on April 11, 1973. Since the district court found and plaintiff agrees that the discovery of the fraud dates from May of 1970, the federal cause of action is barred by the two-year limitations rule we announce today.[4]

THE STATE CLAIM

[4, 5] All the parties to this suit are residents of Florida. Hence the district court was empowered to hear a claim based on violation of the state common law of fraud only in the discretionary exercise of pendent jurisdiction. In light of its plausible, though erroneous, conclusion that the federal cause of action was not barred by the applicable statute of limitations, the court below was unquestionably justified in considering the issue of liability for fraud under Florida law.

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[3] Though we look to state law for the length of the limitations period, the date when a claim accrues so as to trigger the state law limitation period is a matter of federal law and our court-fashioned rule is that a 10b-5 claim accrues when the plaintiff actually discovers the alleged fraud. Sargent v. Genesco, Inc., 5 Cir. 1974, 492 F.2d 750, 758. Hence our acceptance of the two year term imposed by §517.21 in no way constitutes an adoption of the statutory provision that the time be measured from the date of sale rather than the date of discovery. We "borrow only the chronometric aspects and not the procedural or substantive nuances of the law of the forum." Wolf v. Frank, 5 Cir. 1973, 477 F.2d 467, 475.

[4] Plaintiff argues that, notwithstanding the similarity between the federal and Florida securities laws, we are precluded from utilizing the blue sky limitations period by our decision in Azalea Meats, Inc. v. Muscat, 5 Cir. 1967, 386 F.2d 5. While it is true that in *Azalea Meats* the Court applied Florida's three year limitations period for common law fraud to a 10b-5 suit, it is equally clear that the parties had raised no question either in the district court or on appeal as to the propriety of that action. We have noted in recent opinions the existence of a live question concerning the statute of limitations to apply in these Florida cases, though particular facts have intervened in each instance to make a decision on that issue unnecessary. *See* Wolf v. Frank, *supra*, 477 F.2d at 475; Sargent v. Genesco, Inc., *supra*, 492 F.2d at 758.

Plaintiff's complaint presented a federal question of "substance sufficient to confer subject matter jurisdiction on the court," and the "state and federal claims . . . derive[d] from a common nucleus of operative fact." United Mine Workers v. Gibbs, 1966, 383 U.S. 715, 725, 86 S.Ct. 1130, 1138, 16 L.Ed.2d 218. Article III requires no more; and, given the significant overlap of the evidence necessary to prove the respective contentions, all "considerations of judicial economy, convenience and fairness to litigants" argued in favor of the assumption of federal jurisdiction over the entire case. *Id.* at 726, 86 S.Ct. at 1139.

[6] The question now occurs, however, as to whether, having determined that the federal claim ought to have been dismissed at the outset, we should proceed to review the holding on the pendent state claim or remand that count to the district court with directions to dismiss for want of jurisdiction. Confronting the identical question in Parrent v. Midwest Rug Mills, Inc., *supra*, the Seventh Circuit considered these alternatives and determined to review the pendent cause on its merits, noting that,

> [c]ertainly judicial economy directs that we dispose of the issues here instead of sending the case back to the district court with directions to dismiss [the state law counts] and virtually sending the plaintiffs to the state court where it is likely that the case would go through the trial and appellate courts. The parties would be greatly inconvenienced by having to retry the issues. It also would be unfair to the parties, who have litigated the issues in a . . . trial in the district court and

> filed briefs and argued here, to have us refrain from disposing of [the state law counts] after passing on the judgment with respect to the other counts, especially in view of the "federal judicial resources" already committed.

455 F.2d at 129. We find this reasoning persuasive; for, as the *Parrent* Court observed, the very factors which *Gibbs* lists as militating in favor of the exercise of pendent jurisdiction at the trial level—judicial economy, convenience, and fairness—support review of the entire case here.

[7] Though not entirely without merit, defendants' arguments on the substance of the state claim can be quickly stated and as easily dispatched. They first contend that this action, filed in April of 1973, does not come within the three-year statute of limitations applicable to suits for relief on the ground of fraud. Section 95.11(5)(d) provides that a cause of action for fraud shall not "be deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud." The state courts have adopted a so-called "objective" standard, charging the plaintiff with "knowledge of facts which would have been discovered in exercise of due diligence." Matthews v. Matthews, 222 So.2d 282, 284 (Fl. App., 2d Dist.1969), quoting

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Despite the availability of an action under §517.21 for sales in violation of the blue sky laws, Florida has explicitly preserved all other remedies historically available.

> Nothing in this chapter shall limit any statutory or common law right of any person to bring any action in any court for any act involved in the sale of securities, or the right of the state to punish any person for any violation of any law.

§517.22 Florida Statutes.

Azalea Meats, Inc. v. Muscat, S.D.Fl.1965, 246 F.Supp. 780.

[8, 9] The district court dated Hudak's knowledge of the fraud from May of 1970, when his attorney discovered that certain of Petersen's statements on the economic vitality of a recommended company were untrue. Defendants advance as an alternative time of revelation July of 1969, nearly four years prior to filing, when Petersen convinced Hudak to accept 5,000 shares of the bogus Marine Environmental Data, Inc. in place of a requested investment. The court below specifically rejected this argument, finding that Hudak reasonably accepted Petersen's explanations on the superior quality of the Marine Environmental enterprise. While plaintiff Hudak, a Catholic priest, might well have credited Petersen's assurances more readily than an experienced securities trader or a natural sceptic, we cannot say that his continued confidence in Petersen dropped below the level of reasonable trust into credulity or naivete. Though the law of fraud does not endorse a hear no evil, see no evil approach, neither does it require that an aggrieved party have proceeded fom the outset as if he were dealing with thieves. The action was timely filed.

[10-12] Defendants finally contend that, granting the full measure of Petersen's fraud, it may not be charged to them. As to the corporate defendant ERA, this position is indefensible. Under settled precepts of Florida law, a principal is liable to third parties for the fraudulent acts of its agents if those acts were committed within the scope of the agents' employment and authority. One Hour Valet of America v. Keck, 157 So.2d 83 (Fl.App., 2d Dist.1963). The boundaries of an

agent's authority are "determinable as questions of fact, and the findings will not be set aside unless clearly erroneous" *Id.* at 83. The district court directed explicit attention to this matter in its findings of fact and held that Petersen had indeed worked his devious plan within the parameters of his agency. Our examination of the record has disclosed no basis for disturbing that conclusion.

[13] The individual defendant McIntyre stands on much firmer ground, however, with this objection. The judgment against him turned exclusively on the district court's determination that he was a "controlling person" within the meaning of section 20 of the Securities Exchange Act of 1934*, and hence liable for failure to supervise Petersen adequately. Whatever the merit of that holding as a matter of federal law, it does not suffice to make out a claim under the common law of Florida. There are no findings that ERA is merely a corporate *alter ego* for McIntyre, that McIntyre participated in Petersen's schemes, or that he permitted Petersen to continue in employment with knowledge of the latter's crooked ways. In the absence of such demonstrations, the law of Florida does not call McIntyre to account.

The judgment is therefore affirmed insofar as it imposes liability on defendant ERA, and reversed as to defendant McIntyre.

Affirmed in part, reversed in part.

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* 15 U.S.C. §78t(a).

APPENDIX C

No. 73-619-Civ-PF
[FILED OCT 1 1973]

CYRIL M. HUDAK,
Plaintiff.

v.

ECONOMIC RESEARCH ANALYSTS, INC., and RICHARD W. McINTYRE,
Defendants.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF FLORIDA

FINDINGS OF FACT AND CONCLUSIONS OF LAW

THIS CAUSE came on to be heard before the Court for a non-jury trial on September 27 and 28, 1973. Having heard the testimony and considered the record in this cause, and the briefs submitted by Plaintiff's and Defendants' counsels, the Court now enters the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

1. The Plaintiff, CYRIL M. HUDAK, (hereinafter referred to as the Plaintiff) is a citizen of

the State of Florida, and resides in the Southern District of Florida.

2. The Defendant, ECONOMIC RESEARCH ANALYSTS, INC., (hereinafter referred to as "ERA") is a corporation organized under the laws of the State of Florida and has its principal place of business in the Southern District of Florida.

3. The Defendant, RICHARD W. McINTYRE, (hereinafter referred to as "McINTYRE") is a citizen of the State of Florida, and resides in the Southern District of Florida.

4. At all times relevant to this cause, ERA was engaged in the business of a broker-dealer of securities.

5. At all times relevant to this cause, ERA was registered as a securities broker-dealer with the State of Florida, and with the United States Securities and Exchange Commission, pursuant to the Securities Exchange Act of 1934, and a member of the National Association of Securities Dealers.

6. During the year 1968, McINTYRE was the President and Treasurer of ERA.

7. During the year 1969, McINTYRE was the Chairman of the Board of Directors and Treasurer of ERA.

8. At all times material to this cause, McINTYRE was an ERA registered principal with the National Association of Securities Dealers, (hereinafter N.A.S.D.) the Florida Securities Commission, and the United States Securities and Exchange Commission.

9. At all times material to this cause, ERA maintained business offices in the Miami, Florida area, with an office on Kane Concourse, Bay Harbour, Florida, and an office on Biscayne Boulevard, Miami, Florida.

10. From September 13, 1968, through July 11, 1969, Richard F. Petersen (hereinafter referred to as "Petersen") was employed by ERA, and was registered with N.A.S.D. and with the Florida Securities Commission as a registered representative employed by ERA to sell securities to the public.

11. The Plaintiff at all times material to this cause was a customer of ERA, with his stock and mutual fund transactions being handled by Petersen.

12. Although an account was never opened in the Plaintiff's name with ERA, the Plaintiff was aware of Petersen's position as a registered representative of ERA, and reasonably believed, under all of the circumstances, that he was dealing with Petersen in his capacity as a registered representative of ERA from September 13, 1968 to July 11, 1969.

13. Plaintiff visited at the ERA offices at Kane Concourse in Bay Harbour, Florida, and at Biscayne Boulevard, Miami, Florida on several occasions and also placed numerous telephone calls to Petersen at the offices located at the said addresses in regard to various stock and mutual fund transactions.

14. At all times from September 13, 1968 to July 11, 1969, McINTYRE knew or should have known, that Plaintiff was a customer of Petersen.

15. ERA was a member of the group of securities brokers selling Colonial Ventures mutual fund shares to the public.

16. Petersen, in his capacity as a registered representative of ERA, made several sales of shares in the Colonial Ventures mutual fund to the public, and received commissions from ERA for such sales.

17. On or about January 24, 1969, the Plaintiff, upon the recommendation of Petersen and other employees of ERA tendered to Petersen, in his capacity as a registered representative of ERA, a cashier's check, specially endorsed to Petersen in the amount of Five Thousand Dollars ($5,000.00) for an investment by the Plaintiff in the Colonial Ventures mutual fund.

18. Petersen fraudulently converted the Plaintiff's $5,000.00 to his own use.

19. Petersen never tendered or delivered to the Plaintiff any of the Colonial Ventures shares.

20. Petersen never acquired or furnished any Colonial Ventures shares for the Plaintiff's account.

21. Petersen never returned the $5,000.00 for the purchase of the Colonial Ventures shares to the Plaintiff.

22. Petersen falsely represented and stated to the Plaintiff that he (Petersen) had caused or would cause to be purchased for the Plaintiff's account $5,000.00 worth of shares in the Colonial Ventures mutual fund.

23. On or about June 17, 1969, the Plaintiff tendered to Petersen, in his capacity as a registered representative of ERA, a check made payable to Petersen in the amount of Five Thousand Dollars ($5,000.00) for the purchase of 5,000 shares of Neureus, Inc. stock for the Plaintiff.

24. In connection with the purchase of Neureus, Inc. stock, Petersen informed the Plaintiff that such a purchase would represent a prudent investment, and induced the Plaintiff to cancel his prior purchase of $5,000.00 for the purchase of Colonial Ventures mutual fund shares and invest, in addition to that $5,000.00, another $5,000.00 for an investment of $10,000.00 in 5,000 shares of Neureus, Inc. stock.

25. Petersen never tendered or delivered to the Plaintiff the 5,000 shares of Neureus, Inc. stock.

26. Petersen never acquired or furnished any of the 5,000 shares of Neureus, Inc. stock for the Plaintiff's account.

27. Petersen never returned the $10,000.00 for the purchase of the 5,000 shares of Neureus, Inc. stock to the Plaintiff.

28. On July 17, 1969, Petersen sent to the Plaintiff, through the United States mail, a stock certificate representing 5,000 shares of stock in Marine Environmental Data, Inc.

29. The Plaintiff never requested or instructed Petersen to acquire the 5,000 shares of Marine Environmental Data, Inc. stock for him.

30. The Plaintiff inquired of Petersen as to why he had not received Neureus stock and Petersen told him that Marine Environmental Data was a subsidiary of Neureus and was, therefore, equivalent to Neureus; that Marine Environmental Data was a good company with substantial assets; that Marine Environmental Data was negotiating for the sales of pollution control devices to several municipalities in Dade County and several major companies, including Florida Power & Light Co; that Marine Environmental Data would shortly go public at a price of $10.00 per share which would make the Plaintiff's investment of $10,000.00 worth $50,000.00. Plaintiff reasonably relying on these representations, agreed to keep the Marine Environmental Data stock. The aforementioned representations of material facts were false and misleading in that at the time they were made Marine Environmental Data was not a good company, but had been a corporation for less than 30 days, had little or no assets, and had not been negotiating with Florida Power & Light Co. for the sale of pollution control equipment.

31. In light of the Plaintiff's relationship to Petersen, the Plaintiff's limited investment and business experience, the fact that Petersen conducted his business with the Plaintiff at the offices of ERA, and under all the other circumstances of the case, the Court finds that the Plaintiff did not know and reasonably should not have known of the fraudulent misrepresentations, and acts of Petersen and the Defendants until the middle of May, 1970, after an attorney hired by the Plaintiff had investigated the status of Marine Environmental Data, Inc.

32. Petersen was terminated as registered representative of ERA in July 11, 1969.

33. Section 27 of the Rules of Fair Practice of the N.A.S.D. provides, in part, that:

> (a) Each member shall establish, maintain, and enforce written procedures which will enable it to supervise properly the activities of each registered representative and associated person to assure compliance with applicable securities laws, rules, regulations and statements of policy promulgated thereunder and with the rules of the Association.
>
> (b) Final responsibility for proper supervision shall rest with the member. The member shall designate a partner, officer, or manager in each office of supervisory jurisdiction, including the main office, to carry out the written supervisory procedures. A copy of such procedures shall be kept in each such office.
>
> (c) Each member shall be responsible for keeping and preserving appropriate records for carrying out the member's supervisory procedures. Each member shall review and endorse in writing, on an internal record, all transactions and all correspondence of its registered representatives pertaining to the solicitation or execution of any securities transaction.
>
> (d) Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses and at least an annual inspection of each office of supervisory jurisdiction.

(f) Office of supervisor jurisdiction means any office designated as directly responsible for the review of the activities of registered representatives or associated persons in such office and/or in other offices of the member.

34. In accordance with Section 27(a) of the Rules of Fair Practice of the N.A.S.D., ERA established written local rules of its own.

35. ERA's local rules specifically prohibit any registered representative from acting independently, from raising money, except as an agent of ERA, from acting as a personal custodian for a client's money, and from accepting money from a client except as the agent of ERA. The rules further provide that ERA is responsible for all the actions of its registered representatives.

36. Pursuant to the rules of the N.A.S.D., ERA is required to provide each of its registered representatives with a copy of ERA's local rules, as well as a copy of the Rules of Fair Practices of the N.A.S.D.

37. In his capacity as an officer of ERA and as a registered principal with the N.A.S.D., McINTYRE was required to establish and diligently maintain a program of supervision over the registered representatives of ERA.

38. It is undisputed that Petersen was employed by ERA and was registered as a securities salesman with that firm from September 13, 1968 to July 11, 1969, and was actually authorized by ERA to sell securities to members of the public at all material times in this case. The Court finds that the misrepresenta-

tions and other fraudulent activities of Petersen in connection with the purchase by the Plaintiff of securities occurred within the course and scope of his employment with ERA. It from the evidence that McINTYRE and ERA were "control persons" within the meaning of Section 20 of the Securities Exchange Act of 1934 as to the activities of Petersen. The evidence clearly shows that ERA and McINTYRE failed to maintain and diligently enforce a proper system of supervision and control of Petersen's activities. Had the Defendants made even a cursory examination or investigation of Petersen's activities or examined his records the fraud which he was perpetrating on the Plaintiff would have been detected. The lack of supervision by ERA and McINTYRE and McINTYRE's allowing Petersen to violate ERA's own rules in the handling of customer's money allowed Petersen to perpetrate the fraud complained of by the Plaintiff and, in fact, facilitated that fraud.

39. The misrepresentations, omissions to state the facts in the conversion of Plaintiff's money by Petersen constituted fraudulent actions under the Securities Exchange Act of 1934 and common law of the State of Florida.

40. This cause was commenced on April 11, 1973.

CONCLUSIONS OF LAW

1. Jurisdiction of this cause is based upon Title 28, United States Code, Section 1331(a), and Title 15, United States Code, Section 78aa.

2. The substantive federal cause of action is created in this case by the Securities Exchange Act of 1934, Section 10(b), Title 15, United States Code, Section 78j(b), which states:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention or such rules and regulations as the Commission may prescribe as necessary or appropriate in public interest or for the protection of investors.

3. The intrastate use of telephones is within the prohibition of Section 10(b) of the Securities Exchange Act of 1934 prohibiting the use of manipulative and deceptive devices in the purchase or sale of securities by the use of any means or instrumentality of interstate commerce.

4. The telephone calls made by the Plaintiff to Petersen regarding the Plaintiff's stock and mutual fund transactions, and the use of the United States mail by Petersen to send the Plaintiff his stock certificates involve the use of an instrumentality of interstate commerce within the meaning of Section 10(b) of the 1934 Securities Exchange Act.

5. Rule 10b-5, Regulations Section 240.10b-5, which was promulgated by the Securities and Exchange Act of 1934, provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of a national securities exchange,
>
> (1) to employ any device, scheme or artifice to defraud, (2) to make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading, or (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

6. The basic test of "materiality" to be applied under Rule 10b-5 is whether a reasonable man would attach importance to the fact not disclosed in determining his choice of action in the transaction in question.

7. Petersen's false representation to the Plaintiff that he (Petersen) had caused or would cause $5,000.00 worth of shares in the Colonial Ventures mutual fund to be purchased for the Plaintiff, and Petersen's conversion of the Plaintiff's money, constituted a misrepresentation of a material fact by Petersen, a device to defraud the Plaintiff, and a fraud upon the Plaintiff as a matter of law.

8. Petersen's false representation to the Plaintiff that he (Petersen) would acquire for the Plaintiff's account 5,000 shares of Neureus, Inc. stock at a price of $10,000.00 constituted a misrepresentation of a material fact by Petersen, a device to defraud the Plaintiff, and a fraud upon the Plaintiff as a matter of law.

9. Petersen's false representations to the Plaintiff that Marine Environmental Data, Inc. was a corporation in existence for a substantial period of time that it was negotiating contracts with several municipalities and corporations, including Florida Power & Light for the sale of its pollution control devices, that it had substantial assets, constituted misrepresentations of material facts by Petersen, a device to defraud the Plaintiff, and fraud upon the Plaintiff as a matter of law.

10. Accordingly, Petersen's omission to state a material fact and his misrepresentations of material facts to the Plaintiff, as well as his conversion of the Plaintiff's money, constituted deceptive devices and contrivances in connection with the sale of securities to the Plaintiff in contravention of the Securities Exchange Act of 1934, Section 10(b), Title 15, United States Code, Section 78j(b), and fraud under the Common Law of Florida.

11. Section 20(a) of the Securities Exchange Act of 1934, which is Title 15, United States Code, Section 78t(a), states that:

> Every person who, directly or indirectly controls any person liable under any provision

> of this chapter or any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

12. Section 20(a) of the 1934 Securities Exchange Act is remedial in nature, and is to be liberally construed.

13. Regulations Section 230.405(f) which was promulgated by the Securities and Exchange Commission under Section 20(a) of the 1934 Securities and Exchange Act, provides that:

> The terms "control" (including the terms "controlling" "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of management and policies of a person by contract or otherwise.

14. Petersen's actions as a registered representative of ERA were under the direction of, and were to be supervised by, McINTYRE and ERA as required by law and the securities agencies of which they were members. Accordingly, McINTYRE and ERA were controlling persons within the meaning of Section 20(a) of the 1934 Securities Exchange Act, Title 15, United States Code, Section 78t(a) during all times material to this cause.

15. Liability is imposed upon a controlling person under Section 20(a) of the 1934 Securities Exchange

Act for the deceptive conduct of a controlled person, if the controlling person failed to maintain and diligently enforce a proper system of internal supervision and control over the controlled person.

16. ERA and McINTYRE, as controlling persons, failed to establish, maintain, or diligently enforce a proper system of supervision and control of Petersen's activities and transactions as a registered representative of ERA. Accordingly, ERA and McINTYRE, as controlling persons, are liable to the Plaintiff under Section 20(a) of the 1934 Securities Exchange Act for the deceptive conduct of Petersen.

17. By not establishing, maintaining, or diligently enforcing a proper system of supervision and control of Petersen's activities and transactions as a registered representative of ERA, McINTYRE and ERA did not act in good faith. As such, neither McINTYRE nor ERA are within the "good faith" clause of Section 20(a) of the 1934 Securities Exchange Act.

18. Since the Securities Exchange Act of 1934 does not contain a statute of limitations, a federal court in a suit brought upon that Act, must look and apply the applicable Statute of Limitations of the forum state.

19. The Florida Statute of Limitations applicable in this case is Florida Statute Section 95.11, which provides that an action may be brought on the grounds of fraud within three (3) years of the date the facts constituting the fraud are discovered by the Plaintiff.

20. "Discovery" means actual knowledge or notice of facts which, in the exercise of due diligence, would have led to actual knowledge of the violation.

21. Since this cause was commenced within three years (3) of Plaintiff's discovery of Petersen's fraudulent activities, the Plaintiff's cause of action is not barred by the three year Statute of Limitations period contained in Florida Statutes, Section 95.11

DATED at Miami, Florida this 1st day of October, 1973.

/s/ Peter Fay
JUDGE, U.S. DISTRICT COURT

APPENDIX D

No. 70-10902

CYRIL M. HUDAK,

Plaintiff,

vs.

MARINE ENVIRONMENTAL DATA, INC.,
a Florida corporation,
FRANCIS C. GIBOUT,
RICHARD F. PETERSEN,
and ANN H. PETERSEN,
jointly and individually,

Defendants.

**IN THE CIRCUIT COURT OF THE
11TH JUDICIAL CIRCUIT
IN AND FOR DADE COUNTY, FLORIDA**

COMPLAINT

COUNT I

COMES NOW the Plaintiff, CYRIL M. HUDAK, by and through his undersigned attorneys and sues the Defendants, MARINE ENVIRONMENTAL DATA, INC., a Florida corporation, FRANCIS C. GIBOUT, RICHARD F. PETERSEN, and ANN H. PETERSEN, jointly and severally and demands damages against said Defendants and alleges as follows:

1. This is an action for damages for fraud for more than $5,000.00 and within the jurisdiction of this Court.

2. On or about July 11, 1969, RICHARD F. PETERSEN and FRANCIS C. GIBOUT, as security salesmen induced the Plaintiff to purchase 5,000 shares of Defendants' corporation for $10,000.00, said money to be used to further the active business operations of said corporation.

3. All of the above mentioned funds were actually given by the Plaintiff to RICHARD F. PETERSEN on or about the dates hereinabove mentioned by checks which RICHARD F. PETERSEN accepted for purposes hereinabove mentioned.

4. RICHARD F. PETERSEN never even paid the above sum into the escrow or trust account or into the Defendant corporation's account but utilized the sums for his own purposes and the own purposes of FRANCIS C. GIBOUT and ANN H. PETERSEN.

5. That the Defendant, RICHARD F. PETERSEN was in a fiduciary capacity with the Plaintiff at the time and for purposes of obtaining the above stated sums from the Plaintiff for the purpose of investing said money into said corporation.

6. That Defendants, RICHARD F. PETERSEN, ANN H. PETERSEN and FRANCIS C. GIBOUT wilfully and knowingly misrepresented the purposes for which they obtained the aforesaid sum of money from the Plaintiff, fraudulently obtaining said sums for Defendants' own personal purposes thereby obtaining

the aforesaid sums through misrepresentations of material facts.

7. That the Defendant, FRANCIS C. GIBOUT was peculiarily in a position to assist Defendant RICHARD F. PETERSEN in this fraudulent conspiracy since Defendant FRANCIS C. GIBOUT was the President of the Defendant corporation and was also a security salesman.

8. That Defendant ANN H. PETERSEN was likewise in a position to assist Defendant RICHARD F. PETERSEN in that she was not only the wife of said Defendant but was also the secretary of the Defendant corporation.

9. All the Defendants have participated wilfully, knowingly and have acted fraudulently and contrary to the law and have and are engaged in a cunning scheme of planning to bilk the Plaintiff and members of the public at large.

10. That the actions of the Defendants jointly and severally reflect a wanton, gross, wilfull fraud entitling Plaintiff to compensatory damages and punitive damages.

11. That the Plaintiff has not been paid any portion of the $10,000.00 hereinabove referred to.

WHEREFORE, Plaintiff demands damages against the Defendants, jointly and individually for fraud and demands compensatory damages of $10,000.00, plus costs and interest, together with punitive damages.

COUNT II

1. Plaintiff reiterates and realleges the allegations of Count I.

2. On or about July 11, 1969 and prior thereto in Dade County, Florida, Defendants solicited Plaintiff to purchase 5,000 shares of MARINE ENVIRONMENTAL DATA, INC. for $2 per share which shares are unregistered securities subject to the provisions of Florida Statute 517.

3. The Plaintiff was induced by Defendants' representations to buy said shares and did in fact, purchase 5,000 shares of MARINE ENVIRONMENTAL DATA, INC. from the Defendants for $10,000.00 a copy of said stock certificate is attached hereto and incorporated in this Complaint as Exhibit "A".

4. Prior to said purchase Defendants individually and as agents of the Defendant corporation misrepresented the true financial condition of MARINE ENVIRONMENTAL DATA, INC., its business operations and the use of the proceeds from the sale of said stock to the Plaintiff.

5. The Plaintiff did not receive adequate information regarding the true financial position of the Defendant corporation, its business operations and the use of the proceeds from the sale of said stock.

6. Subsequent to the purchase of said stock, Plaintiff has received information and believes in truth and fact Defendant corporation is inactive, that it has no business operations as represented and the proceeds

of the sale were used for the personal purposes of the Defendants all of which is in violation of Florida Statute 517.06(11).

7. Plaintiff has tendered the stock to Defendants for return of the purchase price and has been refused.

WHEREFORE, Plaintiff demands return of the purchase price of $10,000 from the Defendants, jointly and severally, plus interest, costs and attorneys fees and all other relief that Plaintiff is entitled to under Florida Statute 517.21 and punitive damages.

DEAN, ADAMS,
GEORGE & WOOD P. A.
Attorneys for Plaintiff
9th Floor, Concord Building
66 West Flagler Street
Miami, Florida 33130

By /s/ THOMAS J. SCHULTE
Thomas J. Schulte